LECTURE 14: THE INEQUALITY OF CAPITAL OWNERSHIP IN EUROPE AND THE USA

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Introduction

- In this lecture we are returning to the question of wealth inequality (i.e. inequalities arising from capital ownership).

- Global wealth today is estimated at approximately $262 trillion. 44% of this is estimated to be owned by 0.7% of the world's population.

- Last week we concluded that the only reason why income inequality declined in the 20th century was because the income arising from capital ownership declined.

- It is therefore essential that we understand how this compression in the inequality of wealth came about.

Reminder

Table 7.2. Inequality of capital ownership across time and space

Share of different groups in total capital	**Low inequality** (never observed; ideal society?)	**Medium inequality** (≈ Scandinavia, 1970s-1980s)	**Medium-high inequality** (≈ Europe 2010)	**High inequality** (≈ U.S. 2010)	**Very high inequality** (≈ Europe 1910)
The top 10% "Upper class"	**30%**	**50%**	**60%**	**70%**	**90%**
including: the top 1% ("dominant class")	*10%*	*20%*	*25%*	*35%*	*50%*
including: the next 9% ("well-to-do class")	*20%*	*30%*	*35%*	*35%*	*40%*
The middle 40% "Middle class"	**45%**	**40%**	**35%**	**25%**	**5%**
The bottom 50% "Lower class"	**25%**	**10%**	**5%**	**5%**	**5%**
Corresponding Gini coefficient (synthetic inequality index)	0.33	0.58	0.67	0.73	0.85

In societies with "medium" inequality of capital ownership (such as Scandinavian countries in the 1970s-1980s), the top 10% richest in wealth own about 50% of aggregate wealth, the bottom 50% poorest about 10%, and the middle 40% about 40%. The corresponding Gini coefficient is equal to 0.58. See technical appendix.

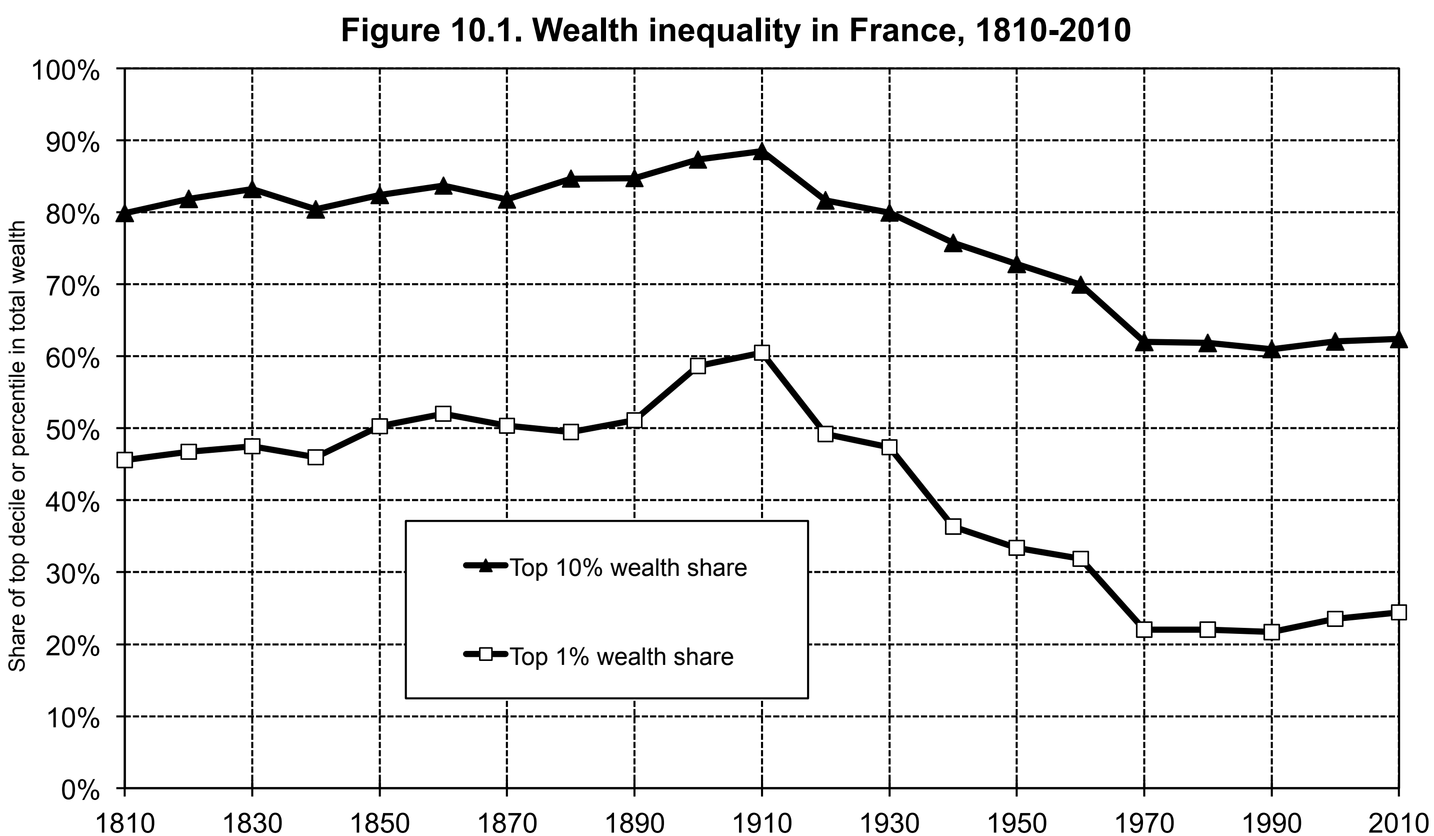
Capital ownership

- Table 7.2 shows that in all known societies the poorest half of the population own virtually nothing (generally 5% of wealth).
  - The world of the 21^{st} century is no different to the world of the 19th century in this sense.

- The top decile have generally owned between 60-90% of wealth. The middle classes have generally owned between 5-35%. This emergence of a property owning middle class transformed wealth distribution in the 20th century.

- Let's take a look at these empirical trends in Europe and the USA overtime.

France

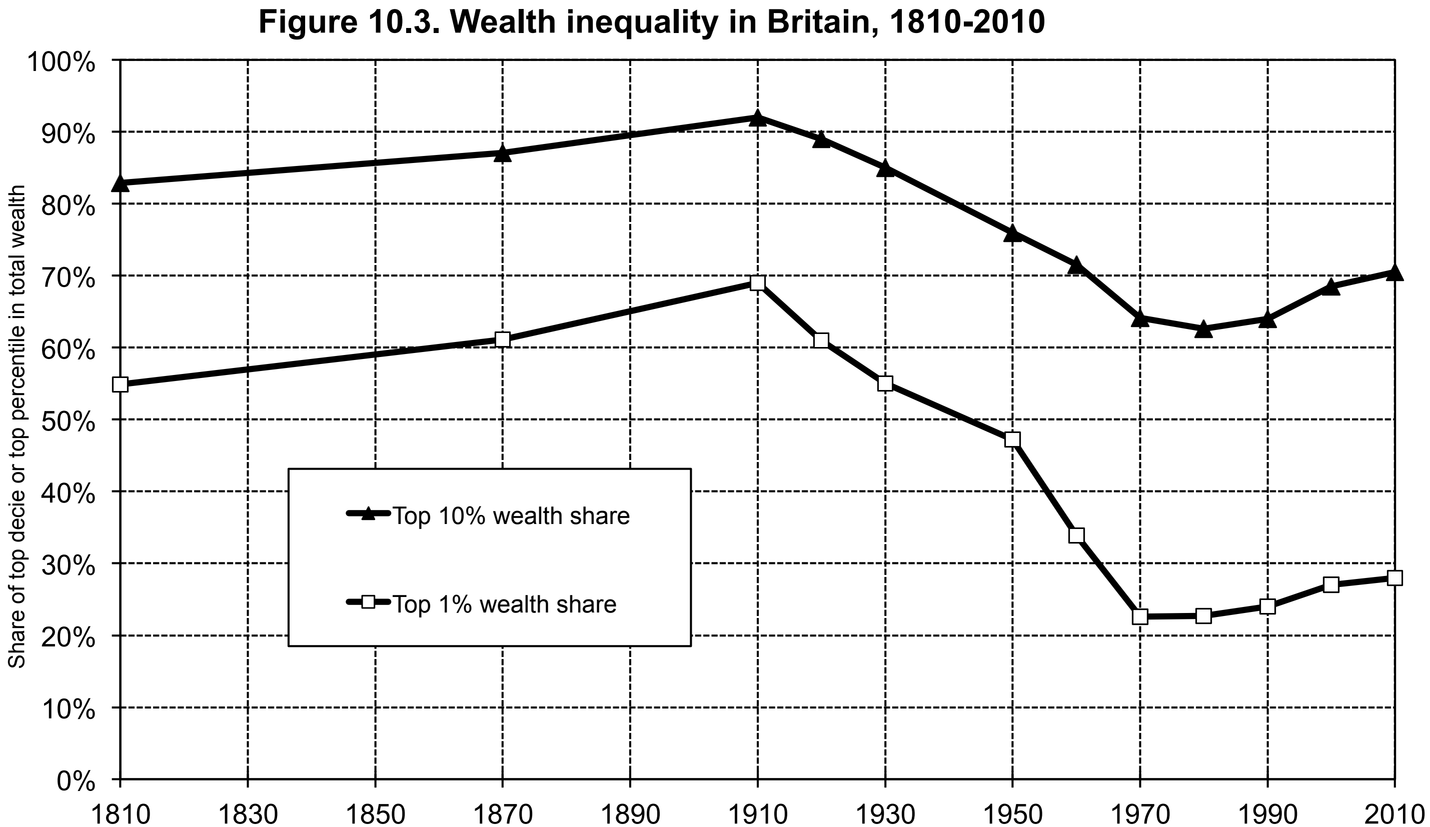


The top decile (the top 10% highest wealth holders) owns 80-90% of total wealth in 1810-1910, and 60-65% today.
Sources and series: see piketty.pse.ens.fr/capital21c.

France

- What we observe in France is that the top decile owned between 80-90% of wealth from 1810-1910 and 60-65% today.
- This longitudinal data is available because of the introduction of an estate tax in 1791 on all forms of wealth; property, assets, bonds, land.
- Looking at these trends in capital ownership it is interesting to ask what would have happened had there been no war?
- France was a patrimonial society characterized by a hyper-concentration of wealth. The decline in the upper decile share of wealth in the 20th century went exclusively to the middle 40 percent of the population.
- The poorest 60 percent owned nothing in the 19th and the 21st century. Much like the structure of wage inequality - this has not changed.

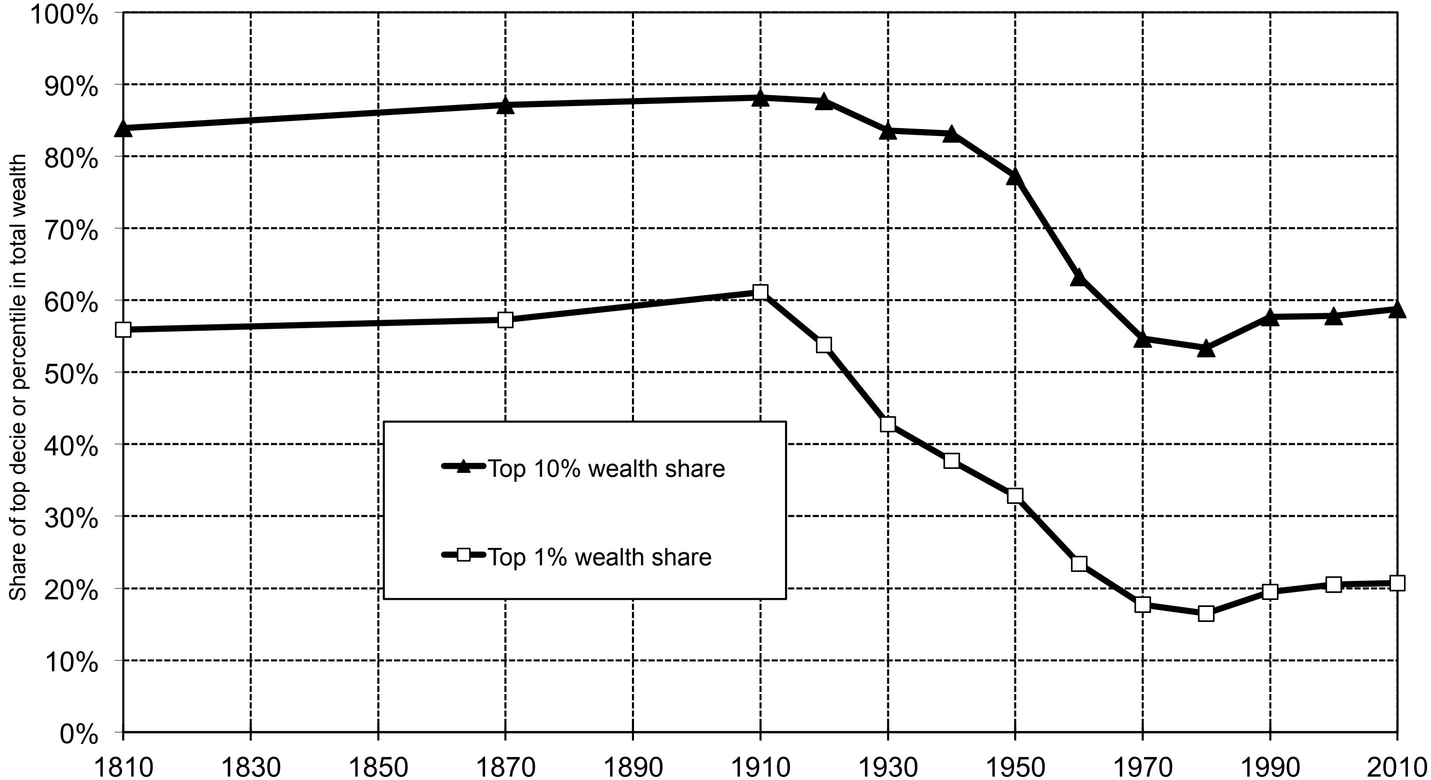
Britain



The top decile owns 80-90% of total wealth in 1810-1910, and 70% today.
Sources and series: see piketty.pse.ens.fr/capital21c.

Sweden

Figure 10.4. Wealth inequality in Sweden, 1810-2010



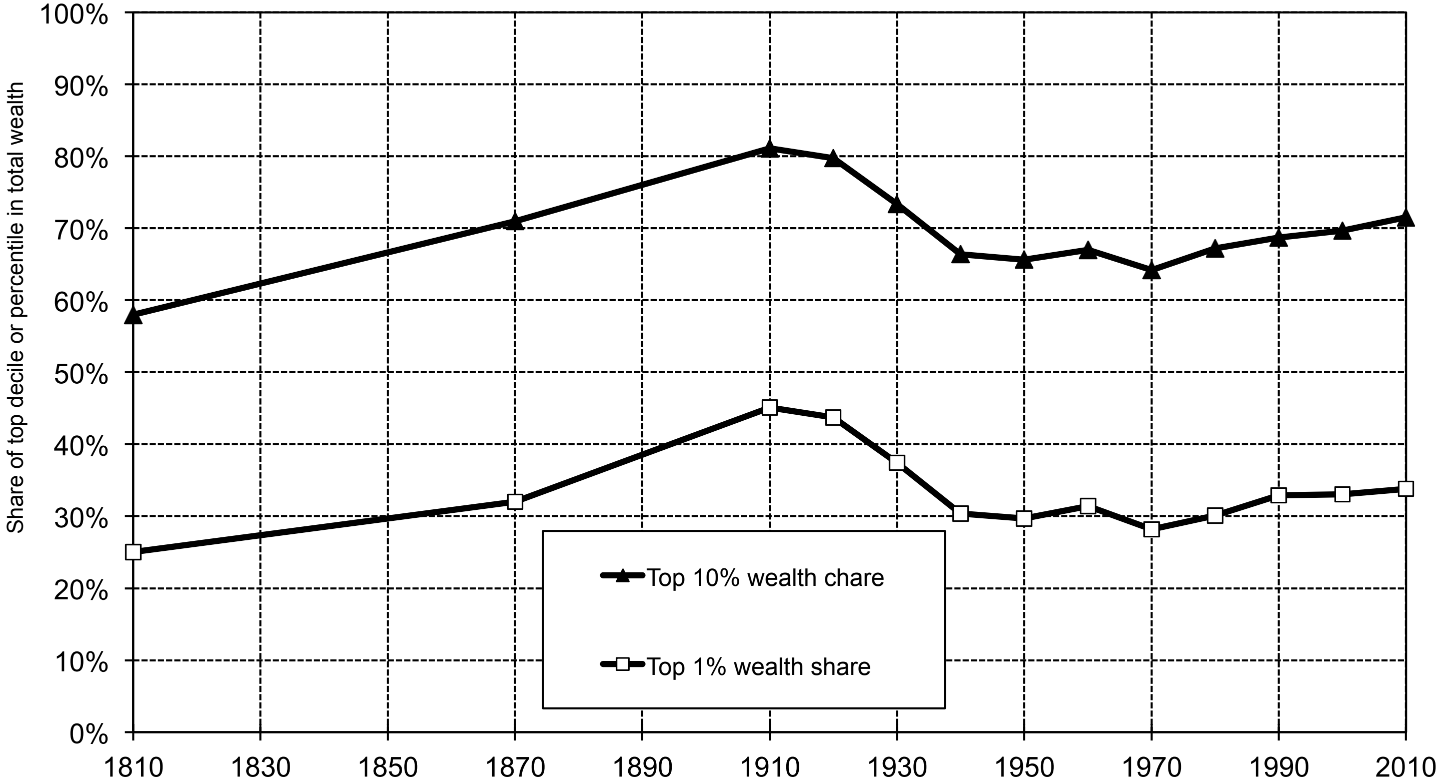
The top 10% holds 80-90% of total wealth in 1810-1910, and 55-60% today.
Sources and series: see piketty.pse.ens.fr/capital21c.

Britain and Sweden

- Figure 10.3 and figure 10.4 show that the same extreme concentration of capital ownership and wealth existed in Britain and Sweden. It was a European wide phenomenon.
- In Britain, the top decile owned 80-90 percent of total wealth in 1910 and 70 percent today.
- In 1910, Sweden was just as unequal. It was nothing like the egalitarian country it became during the 1970's.
- The essential difference today is that there is a property owning middle class - who own about one third of national wealth. The wealthiest 10 percent lost to the middle 40 percent during the period of strong growth in the 20th century.
- Nothing went to the poorest half of the population.

USA

Figure 10.5. Wealth inequality in the U.S., 1810-2010



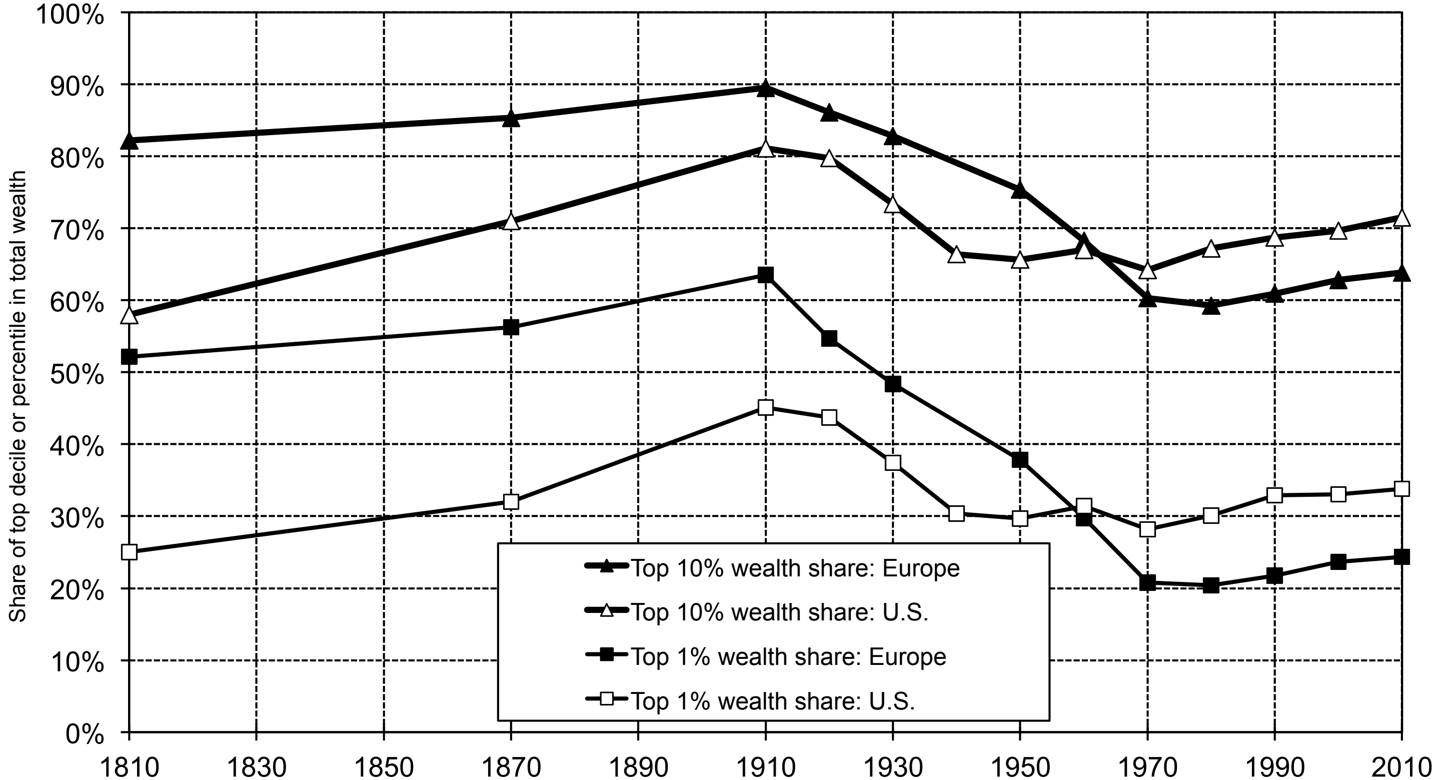
The top 10% wealth holders own about 80% of total wealth in 1910, and 75% today.
Sources and series: see piketty.pse.ens.fr/capital21c.

USA

- Figure 10.5 shows that in the USA the top 10 percent owned 80% of total wealth in 1910 and around 75 percent today.
- We are accustomed to the fact that the US is more unequal that Europe, and that public opinion in the US is more tolerant of inequalities - primarily because they are perceived as an outcome of entrepreneurial dynamism.
- But this was not always the case. A century ago the US prided itself on the fact that it was more egalitarian than Europe.
- From 1910-1930 the US pioneered a progressive income and wealth tax to limit growing inequalities, which were deemed incompatible with the democratic values of the 'free-world'.
- Perceptions and attitudes toward inequality, redistribution and national values have changed a great deal over the 20th century

Europe/USA

Figure 10.6. Wealth inequality: Europe and the U.S., 1810-2010



Until the mid 20th century, wealth inequality was higher in Europe than in the United States.
Sources and series: see piketty.pse.ens.fr/capital21c.

Europe/USA

- Figure 10.6 compares capital ownership and wealth inequality in Europe and the USA.

- The huge decline in Europe during the 20th century created a perception that capital had been tamed

- The assumption was that inequality and a sharply divided *class society* had been relegated to the past.

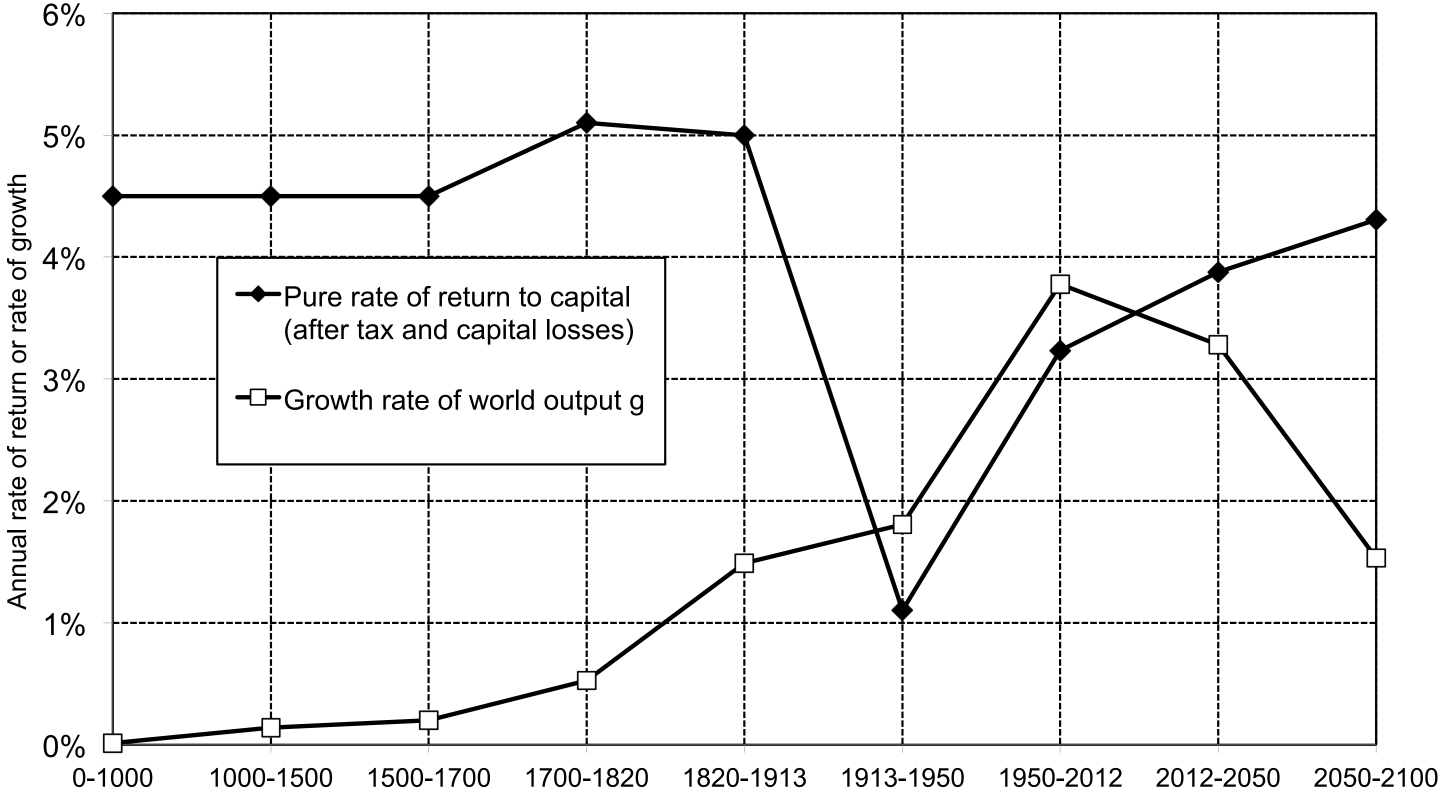
- This has come to a halt – and best observed in the English speaking world.

The Mechanism: R>G

- What explains the hyper-concentration of wealth up until WW1?
- For Piketty, the fundamental macro-social driving force was R>G.
- These were low-growth societies (G) in which the rate of return on capital (R) was markedly stronger.
- If G=1% and R=5% then fortunes grow faster than the economy. This is an ideal condition for an 'inheritance society'.
- Most wealth during the 18th and 19th century came from inheritance.

R>G

Figure 10.10. After tax rate of return vs. growth rate at the world level, from Antiquity until 2100



The rate of return to capital (after tax and capital losses) fell below the growth rate during the 20th century, and may again surpass it in the 21st century. Sources and series : see piketty.pse.ens.fr/capital21c

Taxes and growth

- Before WW1 taxes on capital, profits and property were very low. This changed after WW1.
- Since 1980 and with heightened international competition for capital investment, they have become very low again.
- Figure 10.10 and figure 10.11 show what will happen if capital taxation continues on its downward spiral (intensified capital tax competition) into the 21st century. R>G will return.
- What the data suggests is that the after-tax return to capital fell from 1913-1950 (higher capital taxes) and continued to decline from 1950-2010 (stronger economic growth).
- During the 20th century, and for the first time in history, the net return on capital was less than the growth rate. This benefitted the middle of society.
- This was the period during which the social state, committed to providing public services and social protection, was born. Democracy gave birth to 'social' rights not the capitalist market.

The role of politics

- Figures 10.10 on R>G relies on the assumption that thee will be no political intervention to stop rising inequalities.
- But the R>G inequality is dependent upon and shaped by public policies and institutions i.e. the social and political context within which markets operate, and which are impossible to predict.
- To reverse the R>G inequality, economic growth (G) would need to persistently exceed 2 percent over the coming decades and/or taxes on capital (R) would need to reduce the net return to below 3 percent.
- Left to its own devises the market will ensure that the inequality in capital ownership and wealth will grow indefinitely.
- The *freer the capital-market* the *greater the inequality* of wealth.

Impact of war

- We still need to explain we have not returned to 19th century levels?
- The most important reason was that war in the 20th century brought an end to role of inheritance.
- A new generation did not have the luxury of inheriting fortunes that would enable them to live as their grandparents had.
- The rich lost a lot of their capital assets (not least in their foreign colonies).
- Governments defaulted on the sovereign debt owned to wealthy individuals.
- This meant that those at very top of the wealth distribution (the top percentile) were disproportionately affected.

Taxation

- Total private wealth has (measured in capital/income ratios) regained the level it attained on the eve of WW1.

- The reason why it is has not become as unequal is because governments now tax capital and its income at significant rates.

- Up until WW1 there was no tax on corporate profits. If capital grows at 5% and the average capital tax rate is 30% then the net after tax return to capital will be around 3.5%.

- Taxes on capital do not modify the *accumulation* of wealth. They affect the *distribution* of wealth.

Conclusion

- Wealth inequalities grew throughout the 19th century because of the inequality R>G and the absence of a democratic state.
- Wealth inequalities declined in the 20th century because of the shocks of two wars and the creation democratic social rights
- Piketty suggests wealth inequality will increase to 19th century levels again because of:
  - The return of the inequality R>G (slower growth)
  - Increased tax competition among nation-states in a global financial market (lower taxes).
- On this basis he considers a global wealth tax the only option to defend democracy against economic inequalities.